



One Minute Memo™

The Tax Prevention and Reconciliation Act of 2005

The Tax Prevention and Reconciliation Act of 2005 (signed into law on May 17, 2006) retroactively increases taxes for Americans living abroad. The new tax law includes tax year 2006 and changes the way in which taxes are calculated on subsidies, such as housing allowances, given to Americans living abroad by their employers to protect them from high taxes. By including the value of such items in income, the new law will push Americans living abroad into a higher tax bracket. This law will have more effect on Americans living in countries with low tax jurisdictions and high housing costs, such as Bermuda, the Middle East, Singapore, and Hong Kong. This is because United States citizens receive a credit for foreign taxes paid. As a result of the new tax law, more of the housing subsidy is reported as income and since it is a low tax jurisdiction, the credit for foreign taxes is small. Therefore only a small amount of the tax owed will be offset by the foreign taxes paid credit. There will be little effect on Americans who live in high tax rate countries such as Europe. Since Americans in Europe will receive a larger credit for foreign taxes, the amount of U.S. taxes owed is more significantly offset by the credit. The law will have varying tax effects: some Americans will experience a four-fold increase in tax liability, although other taxpayers will not see any

difference, but the overall effect is expected to be a 6% rise in tax liability. The law increases the amount of income that Americans living abroad may exclude from the income reported to the IRS from \$80,000 to \$82,400. This increase in the income exclusion is not expected to compensate for the increase in the amount of tax that the new law requires American's living abroad to now report. As a result, companies that offer fringe benefits, such as subsidized housing and education, to entice Americans to work and live abroad, will be forced to increase their subsidies, some think by two-fold, to remain attractive as employers to Americans facing higher tax burdens. Confronted with this added cost of hiring Americans, companies may have greater incentive to hire Australians, Britons, Canadians, and other nationalities whose governments will exempt their citizens abroad from income taxes.

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